

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
EXTENDED MARKET PUBLIC REAL ESTATE EQUITY SECURITIES
(EXTENDED MARKET PREES)**

April 19, 2004

This Policy is effective immediately upon adoption and supersedes all previous active PREES policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Extended Market PREES Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, partners, members, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of publicly held real estate.

II. STRATEGIC OBJECTIVE

- A. The real estate securities market is a growing and dynamic segment of the capital markets. Institutional investors have recognized the unique advantages of these instruments in a diversified investment program, which include the following:
 - 1. Exposure to real estate segments that are not available through the direct or private market;
 - 2. Liquid, efficient and cost-effective exposure to real estate generally;
 - 3. The unique risk and return characteristics reflective of the favorable tax treatment for REITs at the corporate level and the resulting distribution of income in the form of dividends, which is especially attractive to a tax-exempt investor; and
 - 4. Publicly traded real estate securities and REITs provide investors with a strong corporate governance structure.
- B. An investment in real estate securities should reflect this changing environment and be sufficiently flexible to capture opportunities as they occur. The Extended Market PREES portfolio ("the Portfolio") shall

provide the System with an opportunity to capture superior returns to the Enhanced Core PREES by allowing an active approach as well as giving flexibility in exit strategies for the Direct Real Estate Portfolio. The Portfolio shall be included as a component of the Specialized (Non-Core) Equity real estate portfolio and, as such, shall be required to achieve an appropriate risk-adjusted return in excess of the Enhanced Core PREES Portfolio held in the core component (Section VI.F. 5).

The strategic objectives of an active investment in PREES are as follows:

1. Provide broad exposure to the specialized (non-core) property type in a publicly traded forum and to other core equity securities, which may or may not be included in the Enhanced Core PREES Index.
2. Enhance the real estate investment program by accessing specialized (non-core) real estate opportunities that are only available in the public securities market.
3. Provide a complement to the direct real estate investment segment in managing the asset allocation to the specialized (non-core) property types and niche opportunities within the overall real estate program.
4. Provide an active approach for investing in both core and specialized (non-core) PREES.
5. Enhance exit strategies for core and specialized (non-core) real estate assets.

III. RESPONSIBILITIES AND DELEGATIONS

- A. **The System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the real estate equity portion of the Policy through Delegations of Authority Nos. 89-13 and 95-50.
- B. **The System's Investment Staff** ("the Staff") duties include, but are not limited to, the following:
 1. Developing and recommending the Policy to the Investment Committee;
 2. Developing and maintaining Program Guidelines, which is subject to periodic review and updating, outlining Staff operational procedures to be used in implementing this Policy;

3. Implementing and adhering to the Policy;
 4. Reporting immediately to the Investment Committee all violations of the Policy with explanations and recommendations;
 5. Reporting to the Investment Committee concerning the performance of the Program on a quarterly basis and monitoring implementation of, and compliance with, the Policy. The Staff shall report all violations of the Policy to the Investment Committee, along with explanations and appropriate recommendations for corrective action; and
 6. Reporting internally to senior management concerning the implementation of this Policy. This report will be prepared monthly to include, but is not limited to, the following:
 - a. Current market value and allocations by asset;
 - b. Aggregate and individual publicly held real estate equity portfolio characteristics;
 - c. Performance of the portfolio versus the benchmark.
- C. The **General Pension Consultant** ("the General Pension Consultant") is responsible for the following:
1. Monitoring and evaluating the Portfolio's performance relative to the benchmark and Policy. The General Pension Consultant shall report to the Investment Committee on a quarterly basis, in accordance with its contract.
 2. Constructing, maintaining and providing the indices to Investment Staff on a timely basis.

IV. PERFORMANCE OBJECTIVE

The performance objective of the Portfolio is to contribute to the Equity Real Estate Program's out performance of the National Council of Real Estate Investment Fiduciaries (NCREIF) Index.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approaches

1. The Portfolio shall be invested to maximize return, within acceptable risk parameters, through the selection of publicly traded equity securities available in United States equity markets and non-United States markets, if appropriate and consistent with permissible countries policy.
2. The Program shall be implemented through internal management, where appropriate competencies exist and where the System's Investment Committee has granted approval to do so.
3. The program may also be implemented through the use of external managers and consultants or both.
4. The Program shall identify opportunities across the real estate equity securities market and invest where risks are both understood and manageable, while maintaining asset quality, liquidity, and performance. Equally important for management of the real estate portfolio is flexibility in managing asset mix by specific security selection. This flexibility is expected to add incremental value versus a passive approach.
5. The Program shall track, manage, and exercise warrants, options, and other derivatives held within the Equity Real Estate portfolio.
6. The Program shall allow the System to enhance its flexibility in the exit strategy of real estate assets by acquiring PREES shares and liquidating them at the prudent direction of the Senior Investment Officer for Real Estate (SIO-RE).

B. Asset Allocation

1. The current asset allocation range for the Portfolio, as a percent of the total real estate equity allocation, is from 0 to 15% based on market values. In any event, the Extended Market Public Real Estate Equity Securities (Extended Market PREES) allocation will not violate current equity allocation ranges as set forth in the Statement of Investment Policy for Equity Real Estate.

From time to time, the actual investment may fall out of the ranges prescribed by Policy. In these instances, adjustments to correct the actual to comply with the Policy allocation ranges shall be implemented on an opportunistic basis during a reasonable time frame (normally within a three-year period) and with ample consideration given to preserving investment returns to the System.

2. The allocation within the range to the Portfolio shall be at the prudent direction of the SIO-RE. The factors considered in asset allocation and selection shall include, but are not limited to, the following:
 - a. The difference in valuation in the public versus the direct market for a particular property type or company;
 - b. The ability to complement exposures in the direct real estate program;
 - c. The ability to facilitate a sale of property to a publicly traded real estate company or Real Estate Investment Trust (REIT);
 - d. Niche opportunities presented in the public market;
 - e. The benefit derived from partnerships with publicly owned companies who are managing the System's assets that demonstrate excellent growth prospects; and
 - f. The benefit of acquiring options and other derivatives in real estate transactions with publicly traded companies. Holdings in derivatives shall comply with all applicable derivative and equity policies.
3. The asset selection process shall include, but not be limited to, analysis of the following factors:
 - a. Liquidity, including average daily trading volume, outstanding market capitalization, bid-ask spread relationships, the estimated transaction cost of investing various dollar amounts, the number and diversity of market makers, and sufficient operating history to ensure continuance as going concerns;
 - b. Investment strategy;
 - c. Operating history;
 - d. Governance and control;
 - e. Real estate asset analysis; and
 - f. Other analysis as necessary in the prudent and professional judgment of the SIO-RE.

C. Implementation

1. The Public Markets group shall construct a portfolio of real estate securities in an active manner. The discretion to buy or sell shall be at the prudent direction of the SIO-RE, but shall be supported by market analysis prior to execution.
2. Trading activity will result from the execution of portfolio allocations made by the SIO-RE and will occur as often as necessary to maintain the desired positions of each security.
3. The acquisition of stocks/derivatives may result as part of a sale of property to a publicly traded real estate company.
4. A variety of trading techniques and liquidity sources shall be utilized to obtain best execution. Crossing networks and other informationless-trading techniques may be used along with private placement investments.
5. Trading costs shall be independently measured no less than quarterly by a third-party vendor to ensure proper trading activity management.
6. The portfolio shall be reconstituted annually as of June 30 for potential additions and deletions to the index.

D. Permissible Investments

1. Securities that are contained in the Enhanced Core PREES Index.
2. Securities that constitute the Wilshire Real Estate Securities Index.
3. Securities which are companies in partnership or strategic alliances with the System in managing and owning real estate.
4. Securities that do not qualify for Enhanced Core PREES Index due to specialized (non-core) property holdings, market capitalization or other reasons; nevertheless, they present a niche opportunity and provide a complement to the real estate portfolio.
5. Securities or derivatives received in exchange for sale of real property or other transactions.
6. Existing holdings of the System that the System desires to manage and hold within this Program and Policy.

E. Restrictions

1. Any security position that represents more than 5% of the outstanding shares of that security shall not be held so as to avoid SEC reporting requirements and liquidity constraints. Liquidation shall be sought as soon as it is cost effective to do so.
2. No more than 10% of total portfolio holdings may consist of non-U.S. real estate properties (exclusive of Canadian holdings).

VI. BENCHMARK

The benchmark shall be the Wilshire Real Estate Securities Index ("WRESI"). Actively managed accounts will have performance criteria custom designed to reflect the investment strategy and risk profile.

VII. GENERAL

- A. All calculations and computations will be on a market value basis, as recorded by the System's custodian.
- B. Terms in this policy are defined in a master glossary of terms.

VIII. GLOSSARY OF TERMS

The Real Estate Glossary of Terms is referenced in the System's Master Glossary of Terms.